

### **Amendments to the Specification:**

Please add the following new paragraph after paragraph [0024]:

[0024.1] Therefore, a need exists for a scalable predictive coding system and method that exploits the information available to the enhancement layer to improve quality without causing undesired conflicts as outlined above. The present invention satisfies those needs, as well as others, and overcomes the deficiencies of previously developed predictive coding systems and methods.

Please replace paragraph [0032] with the following amended paragraph:

[0032] FIG. 1 is a functional block diagram of a conventional two-layer ~~predicting~~ predictive coding system.

Please replace paragraph [0051] with the following amended paragraph:

[0051] Referring now to FIG. 7 and FIG. 8, a system for scalable predictive transform coding which is designed for the compression of video signals is shown. In current practice and standards (e.g., [4]), the system uses motion compensation for basic frame prediction, applies the discrete cosine transform (DCT) to the prediction error (residual), and quantizes the transform coefficients one at a time. A block diagram of a two-layer scalable video encoder is shown in FIG. 7, and the corresponding decoder is shown in FIG. 8. FIG. 9 shows a functional block diagram corresponding to the spatial motion compensator blocks shown in the base layer and the enhancement ~~later~~ layer.